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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ex Parte

August 28, 1997

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop Code 1170
1919 M Street, N.W., Room 222
Washington D.C. 20544

RE: CC Docket No. 96-254

Dear Mr. Caton:

Yesterday, August 26, 1997 Pamela Payuk, Cynthia Barton, Glen Estes, Austin Schlick (Kellogg, Huber, Hansen, Todd & Evans), and the undersigned representing SBC met with Gregory Cooke, Leslie Selzer, Matthew Nagler, and William Howden representing the Common Carrier Bureau's Network Services Division regarding the above referenced docket.

Mr. Schlick reviewed a white paper (attached), prepared by himself, that documents Congressional efforts to lift the MFJ ban on Bell company manufacturing from 1985 to the passage of The Telecommunications Act Of 1996. Mr. Schlick stressed the clear intent of Congress to not require a separate Section 272 affiliate to perform activities pursuant to Section 273 (b) (close collaboration, royalties, research activity). In addition, the SBC representatives indicated the "Carve-Outs" associated with Section 272 (b), namely close collaboration with manufacturers on design and development, research, and royalty agreements, should be authorized with no limitation on the meaning of close collaboration, no limitation on royalty agreements, no separate subsidiary requirements, and no additional duty to disclose or nondiscrimination duties (outline attached).

Prior to the meeting, the Network Services Division had prepared several questions for the SBC team to answer. The questions and the SBC responses are as follows:

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NSD

SBC state in comments (p. 16) that the definition of "certification" should be limited to a process "outside of the testing or evaluation of unaffiliated manufactures' equipment." Please explain. Do you suggest that any evaluation of unaffiliated manufacturers' equipment be excluded from "certification", even when such evaluation is of a product "for use by more than one local exchange carrier"?

SBC

SBC has more than one LEC and anticipates that there will be testing and evaluation activity performed internally by SBC on vendor equipment for use by SBC companies. This type of equipment evaluation for internal purposes should not be considered "certification" under the 1996 Telecom Act. There may also be procurement cases where SBC and one or more unaffiliated Companies form a joint purchasing alliance. Testing and evaluation of vendor equipment by one of the alliance Companies for use by the members should also not be considered "certification" under the 1996 Telecom Act. In both of the above situations, the testing and evaluation process is for internal use of the LECs involved and is not intended to establish a "certification" of the product fitness for use by other parties.

NSD

Please explain SBC's contention that Bellcore will no longer be considered a BOC "affiliate" following its sale to SAIC. How do you define "affiliate" here? The Act, in section 3(1) defines "affiliate" to have equity (10% ownership) and control elements. This definition is revised in section 273(d)(8)(a) to lower the equity element to 5%. Do you believe the 273 definition of affiliate contains a control element? How would you define it?

SBC

Because no Bell company will have any direct or indirect equity interest in Bellcore following the sale, and Bellcore will not be under common control with any BOC, Bellcore will not be a BOAC affiliate under the general definition of "affiliate" in 47 U.S.C. § 153(1), or specific definition in 47 U.S.C. § 273(d)(8). That being the case, there is no need for the FCC to seek to define in its rulemaking the full contours of section 273(d)(8). SBC notes, however, that nothing in this section could be read to impose any "control" test above that stated in section 153.

NSD

If a joint purchasing alliance designated product attributes for a product to be purchased by local exchange companies holding more than 30% of access lines, should this activity be subject to rules that govern "industry-wide" standard setting? Why or why not?

SBC

A joint purchasing alliance designating product attributes for a product to be purchased by LECs holding more than 30% of access lines should not be subject to rules governing

"industry-wide" standard setting as long as the attributes involve standardized products and published interfaces. Under these circumstances, the purchasing alliance should not be considered to be involved in standard setting activity.

NSD

SBC argues that section 273(e) should apply only to manufacturing BOC's. Could royalty agreements or licensing agreements between BOC's and manufactures create similar incentives for a BOC to discriminate in its procurements? SBC also states that the objective of 273 is "not to police the relationship of BOC's with any manufacturer, but to regulate the relationships with affiliated manufacturers." If this is true, how does 273(e) differ from 272?

SBC

Royalty and license agreements authorized under section 273(b) create no consequential incentive to discriminate in procurement. The alleged problems that gave rise to the manufacturing restrictions of the MFJ, and that form the predicate for the restrictions of sections 273(c) and (e), fell within three general categories. First, the Bell System's monopoly power as the buyer of 80 percent of all central office switching and transmission equipment in the United States allowed AT&T to foreclose competition from unaffiliated suppliers. See United States v.Western Elec., 673 F. Supp. 525, 553 (D.D.C. 1987, aff'd in relevant part, 900 F.2d 283, 301-05 (D.D.C. Cir 1990); United States v. AT&T, 552 F. Supp. 131, 174, 190 (D.D.C. 1982), aff'd sub nom Maryland v. United States, 460 U.S. 1001 (1983). Second, as a rate-of-return regulated monopolist, the Bell System had an incentive to self-provide network equipment despite its low quality and high cost. and to cross-subsidize manufacturing operations with local exchange revenues. 552 F. Supp. at 190; 673 F. Supp. at 553-54. Third, because it provided local service to 80 percent of the nation's telephones, the Bell System was able to impede competition in customer premises equipment by favoring Western Electric with respect to establishment and dissemination of technical standards and interconnection requirements for CPE. See Competitive Impact Statement at 14; Decree Opinion, 552 F. Supp. at 191 & 244; Triennial Review Opinion at 553. None of these three concerns had any validity in today's market, particularly with respect to royalty and licensing agreements.

Prior to full manufacturing relief under section 273(a), no BOC would have more than a 10 percent equity interest in any manufacturer with which it has a royalty or license agreement. Furthermore, the realities of the local exchange market establish that no BOC could afford to develop or intentionally favor inferior products. With their own purchases accounting for a small percent of the U.S. equipment market (and an even smaller percent of the global market), no regional Bell company could support a high-cost low-quality product through its own purchases. Local exchange and exchange access competition is already fierce for profitable business customers and will be increasingly so, which will force all BOCs to purchase the highest-quality equipment available to them at the best prices. Just as important, the substantial (if not complete) abandonment of rate-of-return regulation at the federal and state level eliminates or vastly reduces the BOCs incentives to misallocate costs in order to advantage equipment on which they collect royalties. The

BPCs are now unable to sustain inefficient equipment purchases by passing costs through to rate-payers. See Report and Order No. 145, Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, CC Dkt. No. 96-150 (rel. Dec 24, 1996) (price cap regulation provides strong "efficiency incentives" to keep down costs allocated to regulated services); see also First Report and Order and Further Notice of Proposed Rulemaking No. 181, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 as Amended, CC Dckt No. 96-149, FCC 96-940 at Bi, 8(rel. Dec. 24, 1996) (price caps reduce incentives to misallocate costs.

NSD

In arguing that "the RFP process is not sacrosanct" what specific mechanism or process does SBC propose for separating procurement that must be subject to the RFP process and those that do not have to be subject to this process?

SBC

SBC does not believe that Section 273(e) mandates a specific RFP/decision tree process for supply contracts for equipment, services, or software as long as the procurements are done on the basis of an objective assessment of "price, quality, delivery, and other commercial factors."

NSD

Why is SBC opposed to making its procurement standards or factors available for evaluations? Why shouldn't corporate policy on procurement be made public? Weren't such policies public under MFJ administration? Could SBC supply a copy of the procurement standards it adopted under MFJ administration? Does it still use those standards?

SBC

SBC considers its procurement practices to be proprietary/confidential and has offered to provide a copy of its current practice to the FCC staff under proprietary cover.

NSD

Explain SBC's proposed definition of related person and how it fits the intent of the section. If Congress intended related person to mean affiliate why did it not use this term? Why does SBC equate person to an individual rather than a corporate entity?

SBC

SBC agrees that a "related person" under Section 273(e)(1)(B) is not limited to affiliates as defined in section 153(1) or to natural persons. Congress did, however, equate the phrase "affiliate or related person" with, simply, "affiliate." S. Conf. Rep. 104-230 at 155 (1996). Accordingly, SBC suggests that the Commission should interpret "related person" to include persons deemed "affiliates" in common usage. As the Department of Justice explained in MFJ proceedings, this would include entities in which the BOC has an non De

Minimis equity interest, voting rights, or management control, but not other sorts of relationships. Motion of the United States for a Declaratory Ruling Regarding the Receipt of Royalties on Third-Party Sales of Telecommunications Products at 9-10, United States v. Western Elec. Co., No. 82-0192 (D.D.C. filed Jan. 4, 1989).

NSD
In defining services under 273(e)(2), why does SBC propose to limit them to those associated with TE and CPE?

SBC
The overall purpose of Section 273(e) is to prevent BOC discrimination in favor of its manufacturing affiliate. The 273(a) manufacturing authorization covers telecommunications equipment and customer premise equipment. Therefore, it is a logical application of the non-discrimination requirement to services associated with TE and CPE. This reading, moreover, is necessary to harmonize Section 273(e) with other provisions of the Act that address non-discriminatory procurement in other contexts, such as Section 272(c)(1).

NSD
Does SBC keep records of its procurements? If it does, why would auditing these records cause an undue burden? Could undue burden be quantified? If SBC agrees that "sales records of a BOC manufactures or a BOC manufacturing affiliate might provide insight into the sales restrictions imposed by a BOC manufacturer," why wouldn't it agree that procurement records might provide insight into discriminatory procurement practices?

SBC
As a good business practice, SWBT maintains records of its purchase decision process. Mandatory audits and reporting would only increase administrative cost and burden beyond those that other telecommunications competitors experience. Further, SBC believes that additional mandatory audits and reporting on BOC procurements from affiliated manufacturers are unnecessary in light of the Section 272(d) separate affiliate audit provisions.

NSD
The SBC definition of "close collaboration" is broad and seems to be limited to fabrication-oriented activities. Thus the proposed definition would seem to include certain elements of design and development of hardware and software integral to Telecommunications Equipment and Customer Premises Equipment, both of which are elements of manufacturing as defined by the MFJ court and part of the NPRM recommended definition. Why would we not include design and development as part of the definition?

SBC
Product specific design and development are not restricted by Section 273(a) when these activities are performed by a BOC or a BOC affiliate in conjunction with an unaffiliated

manufacturer's design and development process. Unlike the design and development authorized by Section 273(a) -- subject to the safeguards of Section 272 and 273(a) and (e) -- "close collaboration" requires the participation of an unaffiliated manufacturer which is itself a safeguard against anticompetitive conduct by the collaborating BOC. Moreover, unlike activities authorized under Section 273(a), close collaboration does not include fabrication or sale of telecommunications or CPE by the BOC or the BOC affiliate.

NSD
You assert that the Act does not bar BOC affiliates from manufacturing. Please discuss.

SBC
The basis for the argument in SBC's comments is from the text of Section 273(a).

Please include this letter and the attachments in the record of these proceedings in accordance with Section 1.1206(a)(1) of the Commission's rules.

Acknowledgment and date of receipt of this transmittal are requested. A duplicate transmittal letter is attached concerning this matter.

Respectfully submitted,

Rich Brown

Attachments

CC: Gregory Cooke
Leslie Selzer
Mathew Nagler
William Howden

THE SCOPE OF PERMITTED BELL COMPANY MANUFACTURING UNDER SECTION 273 OF THE COMMUNICATIONS ACT

It was widely acknowledged for a number of years that the AT&T consent decree's prohibition on Bell company manufacturing imposed substantial costs on society, in the form of lost jobs, depressed research and development, dampened innovation, and a weakened United States trade position.[1] The Telecommunications Act of 1996 finally lifted the decree's absolute restriction; allowed the Bell companies immediately to engage in full manufacturing activities; and, through section 273(a) of the Act, provided an avenue for complete manufacturing relief.

While seeking to encourage Bell company participation in manufacturing, Congress also established safeguards to ensure that the market is not harmed by Bell company entry. Thus, under section 273(a), a Bell company may not engage in general manufacturing until the FCC has authorized that company to provide in-region interLATA services pursuant to section 271(d) of the Act. Moreover, once a Bell company has obtained complete manufacturing relief, it must comply with various safeguards, including manufacturing through a separate subsidiary (for a period of 3 years), disclosing network information, and purchasing equipment based on nondiscriminatory criteria. See 47 U.S.C. §§ 272(a)(2)(A), 273(c)&(e).

Congress did not, however, think it necessary to impose these safeguards on the collaborative design, research, and funding activities that the Bell companies were allowed to commence immediately upon enactment. Section 273 (b) expressly carves out these activities from the general conditions applicable to Bell company manufacturing. These activities,

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[1] Section II(D)(2) of the Modification of Final Judgment ("MFJ"), as amended by section VIII(A), forbade a Bell company from manufacturing or providing telecommunications equipment, or manufacturing customer premises equipment. United States v. AT&T, 552 F. Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

Congress concluded, present virtually no opportunity for abusive practices, and are especially important for a healthy U.S. manufacturing industry.

The Telecommunications Industry Association ("TIA"), an association of equipment manufacturers that unsuccessfully opposed key provisions of section 273, urges the FCC to narrow the relief granted by Congress and to add a host of unintended and unnecessary burdens on Bell company manufacturing. As explained below, none of TIA's proposed restrictions is found anywhere in the language of the Act or its legislative history. They would, moreover, defeat Congress's objective of infusing domestic manufacturing with Bell company resources and expertise.

BACKGROUND

Congressional efforts to remove the MFJ's ban on Bell company manufacturing began well before the 104th Congress. Indeed, as early as 1985, legislators who doubted the wisdom of forbidding the Bell companies to participate in the design and development of communications equipment began to propose legislation to eliminate the manufacturing restriction.[2]

1. The Department of Justice Report

In 1987, concerns about the ban intensified when the Department of Justice released a report that concluded that the manufacturing restriction was not only unnecessary, but detrimental. Preventing Bell companies from manufacturing, in the Department's view, was no

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[2] See 131 Cong. Rec. E4985 (daily ed. Nov. 5, 1985) (statement of Rep. Tauke); 132 Cong. Rec. E278 (daily ed. Feb. 6, 1986) (criticizing the "costly and draconian" manufacturing restriction) (statement of Rep. Wyden); 132 Cong. Rec. E2988, E2991 (daily ed. Aug. 15, 1986) (statement of Rep. Swift); 132 Cong. Rec. S4760 (daily ed. Apr. 23, 1986) (statement of Sen. Gore); 133 Cong. Rec. S148 (daily ed. Jan. 6, 1987); 133 Cong. Rec. E1398, E1423 (daily ed. Apr. 10, 1987) (statement of Rep. Tauke); 133 Cong. Rec. H7809 (daily ed. Sept. 22, 1987); 134 Cong. Rec. E3612 (daily ed. Oct. 21, 1988); 134 Cong. Rec. S16152 (daily ed. Oct. 21, 1988).

longer justified because several changes since the breakup of AT&T had eliminated any serious risk of anticompetitive behavior. The biggest change was the breakup itself: a vertically-integrated monopoly — pre-divestiture AT&T — had been replaced by eight independent companies, leaving each regional Bell company accounting for "no . . . more than a relatively small percentage of the purchases in any equipment market."[3] In addition, the Justice Department concluded that certain regulatory actions, such as the adoption of FCC rules governing disclosure of network design information, would prevent a Bell company from constructing its network to favor an affiliated equipment manufacturer. DOJ Report at 163-65. Also, the FCC's (then) new cost-allocation rules and the emergence of independent benchmarks for judging cost-allocation and equipment-purchasing decisions would control the potential for cross-subsidization. Id. at 165.

The Justice Department further concluded that the needless MFJ restriction was imposing significant "costs on society." Id. at 167. In addition to denying each Bell company the efficiencies of integration (including the ability to share common costs, to exchange technical and engineering expertise, and to engage in joint research), the prohibition would — the Department rightly predicted — engender costly litigation to test the boundary between permissible and impermissible activity. Id. at 167-69.

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[3] Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment, at 161 (Feb. 2, 1987) ("DOJ Report"); see also id. at 162, n.318 ("no single BOC's purchasing decisions . . . can have much impact on competition in the market as a whole"). Today, none of the five current regional Bell companies accounts for more than 4 percent of U.S. telecommunications equipment expenditures, or 2 percent of global expenditures.

On the basis of these conclusions, the Department of Justice, on behalf of the United States, recommended that the MFJ court remove the prohibition on Bell company manufacturing completely and immediately. The court did not take that recommendation, however, and instead denied the Bell companies' ensuing petition to remove the manufacturing restriction. United States v. Western Electric Co., 673 F. Supp. 525, 552-62 (D.D.C. 1987), aff'd in relevant part, 900 F.2d 283, 301-05 (D.C. Cir. 1990).

2. S. 173

The court's decision precipitated passage of S. 173 — the Senate bill that would, five years later, form the basis of section 273 of the 1996 Act.[4] The Senate Commerce Committee, which had jurisdiction over S. 173, found not only that it was inappropriate for a single judge to be administering the nation's telecommunications policy,[5] but also that the MFJ court's judgment about the consequences of the manufacturing restriction was dead wrong. Whereas Judge Greene concluded (as TIA argues today)[6] that there was a "flowering of research, development, innovation," and competition under the decree, 673 F. Supp. at 560, the Commerce Committee found that the manufacturing restriction, among other things, "discourage[d] . . . research," was "a barrier to the introduction of new equipment and services," "sever[ly] limit[ed] the ability of small manufacturing companies . . . to find funding," hampered the "business activities of every

[4] S. Rep. No. 23, 104th Cong., 1st Sess. 45 (1995) ("S. Rep. 104-23") (manufacturing provision of the 1996 Senate bill was "[b]ased in large part on S. 173, introduced by Senator Hollings and others in the 102d Congress and approved by the Senate on June 3, 1991").

[5] S. Rep. No. 41, 102d Cong., 1st Sess. 14-17 (1991) ("S. Rep. 102-41"); see also 137 Cong. Rec. S6966 (daily ed. June 4, 1991) (statement of Sen. Hollings).

[6] Materials from TIA's Ex Parte Presentation to the FCC, May 2, 1997, § I(A) ("TIA Materials").

telecommunications manufacturer in America," and drove investment and tens of thousands of manufacturing jobs offshore. S. Rep. 102-41, at 18-26 (internal quotations omitted).[7]

More significantly, the Committee concluded (again contrary to both the findings of the district court and the current arguments of TA) that "[a]llowing the BOCs to manufacture [would] not cause anticompetitive harm to the communications equipment market." S. Rep. 102-41, at 28 (emphasis added). The Committee found that "[t]he divestiture of AT&T into eight separate companies, the globalization of the communications equipment market, the concentration of equipment suppliers, the increasing foreign penetration of the U.S. market, . . . the continued dispersal of equipment consumption," and "enhanced regulatory safeguards" "ha[d] substantially reduced the possibility that the BOCs could gain an anticompetitive advantage in manufacturing." S. Rep. 102-41, at 28; see also id. at 28-32.

In light of these findings, the Senate proposed to lift the manufacturing restriction completely, so long as the Bell companies complied with a series of statutory safeguards "[i]n conducting their manufacturing activities." S. Rep. 102-41, at 40. The bill was endorsed by the FCC, the Department of Commerce, and the Department of Justice, and was easily approved by the Senate.[8]

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[7] The Senate also accepted the findings of a 1989 study by the Commerce Department's National Telecommunications and Information Administration, which found that the manufacturing restriction had "impaired both the pace at which innovations are being brought to the market and the overall cost of that process." 137 Cong. Rec. S6911, 6916 (1991) (statement of Sen. Hatch) (citing NTIA, The Bell Company Manufacturing Restriction and the Provision of Information Services 34 (Mar. 1989)).

[8] 137 Cong. Rec. S6970, S7106 (daily ed. June 5, 1991).

The House of Representatives, during the same period, considered a bill containing virtually identical language. Although it gathered 138 sponsors,[9] this bill was never brought to a full vote.

3. The 1996 Act

Like those that preceded it, the 104th Congress recognized the potential benefits of allowing Bell company participation in manufacturing, see 142 Cong. Rec. S699 (daily ed. Feb. 1, 1996) (statement of Sen. Lott), and once again predicted the Bell company entry would "foste[r] competition . . . and creat[e] jobs along the way." S. Rep. 104-23, at 67.[10]

To achieve these benefits, the Senate "[b]ased" the manufacturing provisions of its bill, S. 652 "in large part" on S. 173. S. Rep. 104-23, at 45. The House also lifted its version almost entirely from the 1991 legislation. It is no surprise, therefore, that the language of section 273, as finally enacted, can be traced directly to S. 173; for example, subsections (b)(1), (c)(1), (c)(2), (c)(3), (c)(4), (e)(1), (e)(3), (g), and (h) of section 273 can be found — nearly word-for-word — in the old Senate bill.

Unlike the old Senate bill, section 273(a) of the 1996 Act authorizes a Bell company to engage in most manufacturing activities only after the company has received in-region interLATA relief. But Congress did not impose this timing restriction on three types of Bell

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[9] 137 Cong. Rec. E3566 (daily ed. Oct. 28, 1991) (statement of Rep. Slattery); 138 Cong. Rec. E2812 (daily ed. Sept. 25, 1992) (statement of Rep. Slattery).

[10] In 1994, under a different majority party, the same Committee had anticipated that Bell company manufacturing activities could "be expected to stimulate greater spending on research and development, improve the nation's trade position, increase job opportunities, increase the market share of U.S. firms both in the United States and abroad, and give U.S. firms an opportunity to seek funding from another U.S. firm rather than seek capital from overseas." S. Rep. No. 367, 103d Cong., 1st Sess. 6 (1994).

company manufacturing activities that Congress was told would have the most direct benefits and posed the least threat of competitive harm; subsection (b) thus expressly excludes collaboration, research, and royalty arrangements from the basic authorization and restrictions found in section 273(a), allowing the Bell companies to engage in these activities immediately.

ANALYSIS

The conditions Congress placed on Bell company manufacturing were tailored to address specific concerns raised during the legislative debates. For example, section 273's nondiscrimination requirements were designed to deal with potential problems created once a Bell company obtains complete manufacturing relief pursuant to section 273(a). Hence, they are only triggered when that relief is obtained and exercised.

By contrast, when Congress permitted the Bell companies immediately to engage in collaborative design and product-specific research and to enter into royalty-funding agreements with manufacturers, it did so because such arrangements have significant public benefits and pose little or no danger of anticompetitive conduct. Accordingly, Congress neither limited the scope of such arrangements nor intended to impose onerous and self-defeating conditions (such as the separate subsidiary requirement) upon them.

I. THE INFORMATION DISCLOSURE REQUIREMENTS OF SECTION 273(c) AND THE NONDISCRIMINATION OBLIGATIONS OF SECTION 273(e) APPLY ONLY TO A BELL COMPANY THAT IS ENGAGED IN MANUFACTURING PURSUANT TO SECTION 273(a)

TA claims that a Bell company's duty to disclose information about the protocols and technical requirements of its exchange facilities, as prescribed in section 273(c), and its duty to make procurement decisions on the basis of nondiscriminatory and objective criteria, as prescribed in section 273(e), arise irrespective of whether the Bell company is engaged in manufacturing pursuant to section 273(a). See TIA Materials, § IV(A); Reply Comments of the Telecommunications Industry Association, at 14-17, 26-27. TA is wrong for several reasons.

First, such a reading cannot be squared with the plain language of section 273. Subsection (a) provides that Bell company manufacturing must be done "subject to the requirements of this section." If, the requirements of subsections (c) and (e) applied to all Bell companies (whether or not manufacturing), the "subject to" phrase would be entirely unnecessary. See Bailey v. United States, 116 S. Ct. 501, 506-07 (1995) (courts should read a statute "with the assumption that Congress intended each of its terms to have meaning" and thereby follow "the canon of construction that instructs that 'a legislature is presumed to have used no superfluous words'" (quoting Platt v. Union Pacific R.R., 99 U.S. 48, 58 (1878)). Moreover, if Congress had wanted to be redundant when it included this caveat in the delayed manufacturing authorization of subsection 273(a), it would have included the same redundant qualification in the immediate manufacturing authorization of subsection 273(b). Yet subsection (b) contains no such language, proving that the activities authorized by this subsection are not subject to the information - disclosure and procurement restrictions.

Second, TA's theory would mean that Congress placed requirements applicable to all Bell companies within a section devoted to (and entitled) "manufacturing by Bell operating companies," even while it placed other disclosure requirements of general applicability where one would expect — in the provision specifying the general duties of incumbent local exchange carriers. See 47 U.S.C. § 251(c)(5). Further, TA's reading would require the Commission to believe that Congress's heading for subsection (e)(1) — "nondiscrimination standards for manufacturing" — was some sort of misnomer. See Bailey v. United States, 116 S. Ct. at 506 (courts should "consider not only the bare meaning of the word but also its placement in the statutory scheme"); INS v. National Ctr. for Immigrants' Rights Inc., 502 U.S. 183, 189 (1991) ("the title of a statute or section can aid in resolving an ambiguity in the legislation's text").

Third, TA's construction is contrary to the legislative history of section 273. The Senate Report on what became section 273 explains, for instance, that nondiscrimination requirements were among the "safeguards" that the Bell companies must comply with "[i]n conducting their manufacturing activities." S. Rep. 104-23, at 6 (emphasis added). Section 273, the Report adds, "allows [the Bell] companies to engage in manufacturing subject to certain safeguards." Id. at 45.[11]

Simply exercising the immediate, carved-out authority granted by subsection (b) is not enough to trigger the requirements of subsections (c) and (e), moreover. The Senate Commerce Committee drafted the procurement safeguards of section 273 to address the concern that a Bell company might favor its manufacturing affiliate after full manufacturing relief by granting it

[11] See also 141 Cong. Rec. S7893 (daily ed. June 7, 1995) (statement of Sen. Pressler) ("In conducting its manufacturing activities, a Bell company must comply with the [specified] safeguards.").

preferential technical access to the company's network, or by purchasing the affiliate's products instead of an unaffiliated vendor's cheaper or higher-quality goods. S. Rep. 104-23, at 6.[12] The additional information-disclosure requirements added on the Senate floor also were inextricably tied to the separate affiliate requirement that the Senate bill (unlike the final legislation, see infra Part III(B)) imposed on Bell company research, design, and royalty activities as well as full manufacturing.[13] By moving the authorization of research and royalty arrangements from subsection (a) — where they had been in the Senate bill — to subsection (b), the conference committee indicated that it did not want structural separation or other needlessly restrictive safeguards to apply to these activities. See infra Part III(B). In short, it is the receipt and exercise of manufacturing authority under subsection (a), not the status of a Bell company as a former part of the Bell system or mere authorization to manufacture, that triggers the requirements of subsections (c) and (e).

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[12] These forms of anticompetitive behavior were two of the three practices that prosecutors alleged AT&T had engaged in with its manufacturing affiliate, Western Electric. See Western Elec., 673 F. Supp. at 553. The third practice involved subsidizing equipment prices with revenues from telecommunication services. Id. Congress addressed this third potential abuse, in part, through section 272(a)(2)(A)'s separate subsidiary safeguard, discussed below.

[13] See 141 Cong. Rec. S8432 (daily ed. June 15, 1995) (accepting negotiated amendment); id. at S8460 (statement of Sen. Dodd) (amendment intended to "prevent [the] Bell companies' manufacturing subsidiaries from gaining exclusive or early access to the kind of information that is the lifeblood of telecommunications manufacturing") (emphasis added). See also 47 U.S.C. § 273(e)(3) (authorizing regulations to prevent favoritism toward "manufacturing affiliate" of the BOC or unaffiliated manufacturers.)

II. A BELL COMPANY MAY ENGAGE IN COLLABORATIVE DESIGN AND PRODUCT-SPECIFIC RESEARCH AND MAY ENTER INTO ANY SORT OF ROYALTY AGREEMENT

Because the requirements of subsections (c) and (e) are triggered once the relief authorized by subsection (a) is granted and exercised, they do not apply to the three types of activities separately authorized by subsection (b). Congress chose to treat these activities differently, permitting a Bell company to engage in collaboration and research and to enter royalty agreements immediately and without condition. Specifically, subsection (b)(1) provides that "[s]ubsection (a) shall not prohibit a Bell operating company from engaging in close collaboration with any manufacturer," and subsection (b)(2) provides that "[s]ubsection (a) shall not prohibit a Bell operating company from — (A) engaging in research activities related to manufacturing, and (B) entering into royalty agreements with manufacturers of telecommunications equipment."

TA is unwilling to accept Congress's decision to allow these activities. In an attempt to re-wage before the FCC a battle it lost on Capitol Hill, TA tries to keep the Bell companies from exercising the authority expressly granted them in subsection (b), by arguing, in effect, that the statute authorizes a Bell company to do no more than what it was already allowed to do under the MFJ. TA's position again is contrary to the language and history of section 273.

A. Collaboration May Include Product-Specific Design

The scope of authority granted by the collaboration provision "must be understood against the background of what Congress was attempting to accomplish in enacting" that provision. Gustafson v. Alloyd Co., 115 S. Ct. 1061, 1070 (1995). Congress had recognized that the MFJ's broad prohibition on manufacturing had created costly "obstacles" to research and

innovation, 137 Cong. Rec. S7102 (June 5, 1991) (statement of Sen. Levin), partly because the MFJ precluded Bell company network engineers from consulting with manufacturers of network equipment. While a Bell company was allowed to provide its vendor with "generic requirements" for a new system,[14] it was not allowed to pursue research concurrently with a vendor's designers to develop actual products, nor could it to help solve with the vendor the real-world technical problems that arose in using those products. "The inability to collaborate," Congress concluded, was "caus[ing] delays and increased expense." S. Rep. 102-41, at 52.[15] By removing the restriction and allowing "[c]ollaboration between manufacturers and network engineers and researchers," Congress intended to "produce efficiencies that can lead to new products and innovative services." Id.

TA would have the FCC believe that Congress did nothing to address the problem it set out to fix. TIA contends that section 273(b)(1) authorizes consultation between Bell companies and manufacturers only with respect to "generic" specifications, not "product-specific design activities." TIA Materials, § III(A); TIA Comments at 13. But, under the MFJ, the Bell

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[14] See United States v. Western Elec. Co., 569 F. Supp. 1057, 1114 (D.D.C. 1983), aff'd, 464 U.S. 1013 (1983).

[15] The Senate Commerce Committee reported that the inability to collaborate "helps explain the relatively poor American showing in manufacturing performance." "Constant flows of people, information, and ideas between research and production is characteristic of Japanese firms. In American firms, the processes of research (or design) and production are more often sequential, with the results of developmental work handed over to a different set of people for management of production. There is much less interaction between the designers of the product and the production managers." S. Rep. 102-41, at 52, n.99 (citations omitted). The collaboration provision was designed to address this problem. See id. at 52.

companies were already allowed to define generic product features.[16] While there can be no doubt that the BOCs may still engage in the non-manufacturing collaborative activities allowed under the MFJ, Congress wanted to expand this authorization to allow a Bell company to work with manufacturers in product-specific design.

This intent is reflected in the plain language of subsection (b)(1). In stating that "[s]ubsection (a) shall not prohibit" certain activities, the text makes express that (b)(1) allows activities that otherwise would constitute "manufacturing" covered by (a); product-specific design was considered "manufacturing" under the MFJ, but developing generic specifications was not. Western Elec., 675 F. Supp. at 667-68. Congress plainly thought that, when it authorized Bell companies to "closely collaborate" with any manufacturer, it was permitting the companies to do something that, until then, had been forbidden: to work with manufacturers in the design and development of equipment that would be sold in the marketplace.[17]

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[16] United States v. Western Elec. Co., 675 F. Supp. 655, 667-68 & n.58 (D.D.C. 1987) (distinguishing between generic research and product design); 137 Cong. Rec. S6970 (daily ed. June 4, 1991) (statement of Sen. Hollings) ("The MFJ permits the Bell Cos. to develop generic product standards but bars them from developing products to meet those standards."); 137 Cong. Rec. E1022 (daily ed. Mar. 20, 1991) (statement of Rep. Slattery) ("Under the MFJ, the Bell Cos. may engage in the early steps of the process, including research not involving the design of a specific product. They may define generic product features, but may not determine the detailed design specifications, or construct a prototype.")

[17] In a strained attempt to argue that permitted collaboration does not include collaborative design, TIA points out that 273(b)(1) says that a Bell company may closely collaborate "during the design and development" of equipment. TIA Materials, § III(A)(1). This language is most naturally read as specifically allowing collaborative design. Indeed, Congress described the language as authorizing a Bell company and any manufacturer "to work together in the design and development of CPE and telecommunications equipment." S. Rep. 102-41, at 52 (emphasis added).

B. Research May Include Product-Specific Research

Similarly, there is no basis for limiting "research" to "research of a 'generic' nature," as TIA would have it. See TIA Comments at 15; TIA Materials, § III(B). TIA justifies its proposed limitation on the term "research" by relying on the fact that proposed section 256(A)(2)(A) of the Senate bill would have authorized the Bell companies to engage in "research and design" activities, while at conference the reference to "design" activities was removed. This argument is a non-starter: By removing non-collaborative "design" activities from subsection (b), Congress did nothing to qualify the types of "research" activities that it left in the provision.

As explained above, moreover, "generic" research was already permitted under the MFJ. See Western Elec., 675 F. Supp. at 667-68 n.58. Under the decree, the Bell companies were permitted to develop working prototypes for specific products, as long as they used those prototypes only to develop generic specifications and not to share with manufacturers.[18] Therefore, construing subsection (b)(2)(A) as permitting only generic research would deprive the provision of meaning, for the section would then allow only non-manufacturing activities that were already permitted prior to passage of the 1996 Act and are still permitted without regard to section 273. This clearly was not Congress's expectation. See Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253 (1992) ("courts should disfavor interpretations of statutes that render language superfluous"). Indeed, Senator Warner opposed the research exception precisely on the ground that it "would permit the Bell operating company to undertake

[18] See United States v. Western Elec. Co., 569 F. Supp. at 1114 (Bellcore is authorized to perform "systems engineering," described as "the development of 'generic requirements for new systems' which will enable the Operating Companies to 'inform vendors of the features and functions that the BOCs want or need in the equipment they purchase.'" (quoting AT&T Response to Objections to Its Proposed Plan of Reorganization)).

research . . . aspects of manufacturing." 141 Cong. Rec. S8310, S8361 (daily ed. June 14, 1995).

C. Royalty Agreements May Be Volume-Based and May Include Bell Company Purchases

Nor is there any statutory support for precluding royalty arrangements that compensate a Bell company based on the receipts earned or units produced from use of its property. See TA Comments at 16. Not only is such a limitation absent from section 273(b)(2)(B), but it would exclude a large number of agreements that fall centrally within the common understanding of "royalty agreement." As the FCC has recognized, NPRM ¶ 12, a principal meaning of "royalty" is compensation for the use of property "expressed as a percentage of receipts" or "as an account per unit produced." Black's Law Dictionary 1330 (6th ed. 1990). Congress anticipated — and intended to include — this sort of royalty arrangement. See S. Rep. 104-23, at 6 (Bell companies would receive royalties based on "the manufacturer's sale of the product"). There likewise is no statutory basis for excluding royalty arrangements that compensate a Bell company for equipment it purchases for itself. See TIA Comments at 16.[19]

Where Congress did want to limit the scope of royalty agreements permitted under the Act, it did so expressly. In section 274(c)(2)(C), for example, Congress limited royalty agreements pursuant to electronic publishing joint ventures to 50 percent of gross revenues. Congress also specified in section 274 that royalty agreements would trigger the obligations and restrictions incident to ownership by a Bell company when they exceed 10 percent of the non-

[19] Congress' omission of such a restriction on permitted royalties is particularly significant given that the royalty provision of section 273 was drafted against the background of a pending MFJ waiver that would have imposed this limitation. See United States v. Western Elec. Co., 12 F.3d 225, 236 (D.C. Cir. 1993). Given Congress' intimate familiarity with the MFJ's manufacturing restrictions, it is wholly implausible that Congress' omission of the limitation was unintentional.

Bell company's revenues. 47 U.S.C. § 274(i)(8). No such limitations or restrictions appear in section 273(b)(2)(B), which permits "royalty agreements" without limitation.

Contrary to the suggestion of TIA, permitting royalty agreements that extend to all sales does not open the door to anticompetitive behavior. See TIA Comments at 16. A Bell company can ill-afford to develop or intentionally favor inferior products in a world where Bell companies have a tiny share of overall global buying power,[20] where local exchange competition (especially for the most profitable customers) is increasingly fierce, where technology is developing at a rapid pace, and where rate-of-return regulation has been abandoned at the federal level and in most States.

Any attempt to cap or otherwise circumscribe the type of permitted royalty agreements under section 273(b)(2)(B) would only serve to weaken a Bell company's incentive to enter into such arrangements with manufacturers that are in need of investment or Bell company-developed technologies. Yet Congress was eager to see the Bell companies supporting small manufacturers through such arrangements. See S. Rep. 102-41, at 19-20. The Commission should not frustrate that intent by adding limitations that appear nowhere in the 1996 Act. See NPRM ¶ 12 (noting that subsection (b)(2) should be interpreted to "preserve BOC incentives to research and develop innovative products, solutions and technologies").

III. ACTIVITIES PURSUANT TO SECTION 273(b) NEED NOT BE CONDUCTED THROUGH A SEPARATE SECTION 272 AFFILIATE

TIA attempts to justify excluding product-specific design and development from the authorization of subsection (b), in part, on the theory that reading the terms more broadly would

[20] See supra n. 3.

"undermine" section 272(a)(2)(A)'s general rule that manufacturing activities must be conducted through a separate affiliate. See TIA Comments at 13. But TIA does not have to contort subsection (b) and frustrate the legislative purpose of this provision in order to reconcile it with section 272(a)(2)(A). Collaboration and research can be given their proper scope without requiring that those activities be conducted through a separate subsidiary, by recognizing that section 272(a)(2)(A) is a general rule that must give way to the specific exceptions carved out in section 273(b).[21]

Although Congress intended section 272(a)(2)(A) to apply to manufacturing authorized by subsection (a), it did not expect the separation requirement to apply when a Bell company only engages in collaboration or research, or enters into royalty arrangements, as authorized by subsection (b). Indeed, any such construction would defeat the purpose of subsection (b) by precluding the BOCs themselves from working closely with manufacturers in critical research, design, and development work and royalty arrangements.

A. Requiring Collaboration Through a Separate Subsidiary Would Defeat the Purpose of the Provision

Subsection (b) explicitly carves out certain activities from the temporary prohibition on manufacturing contained in subsection (a). At the same time, it implicitly carves those same activities out from the separate subsidiary requirement that is applicable to BOC manufacturing conducted pursuant to subsection (a). Indeed, it simply makes no sense for the kind of collaboration that Congress envisioned to be conducted through a section 272 separate subsidiary. As explained above, Congress authorized collaboration to allow communication

[21] See Morales v. Trans World Airlines, Inc., 504 U.S. 374, 384-85 (1992) ("it is a commonplace of statutory construction that the specific governs the general").

between a network engineer or researcher, on one end, and the manufacturer of the network's equipment, on the other. Congress had learned that, under the MFJ,

> [i]f a manufacturer tests a piece of equipment on the BOC network, BOC engineers can tell the manufacturer that the product does not work, but they cannot tell the manufacturer why the product does not work or how to fix it. The manufacturer must return to its own shop and try again, with no idea what the problem is. Such a manufacturer must continue in the "trial-and-error" fashion until the manufacturer discovers the problem or abandons the effort completely.

137 Cong. Rec. S7102 (daily ed. June 5, 1991) (statement of Sen. Levin) (quoting S. Rep. 102-41). Congress intended for section 273(b)(1) to redress this problem and put an end to this ludicrous cycle of trial and error. 137 Cong. Rec. S7102 (daily ed. June 5, 1991); S. Rep. 102-41, at 52.

But the cycle would not end — and nothing would be gained — if a Bell company could consult with a manufacturer only through an affiliate that is isolated from the BOC by the stringent structural requirements of section 272. In that case, the manufacturer still could not effectively consult with the BOC's network engineers and researchers. See 47 U.S.C. § 272(b). Congress would have engaged in a pointless legislative exercise. But see Harlan v. Baron, 21 F.3d 209, 212 (8th Cir. 1994) ("[I]t is a cardinal and long-revered canon of statutory construction that Congress is not to be presumed to have done a vain thing").

Only by construing section 273(b)(1) to permit collaboration without a separate section 272 affiliate, does one avoid defeating Congress's ends. Such a reading leaves section 273(b)(1) to function as it was intended: "to allow BOC personnel, personnel of its manufacturing affiliate, and any other affiliate, and any manufacturer, to work together in the design and development of

[customer premises equipment] and telecommunications equipment, including hardware and software." S. Rep. 102-41, at 52 (emphasis added).[22]

The fact that the subsidiary requirement could not reasonably apply to collaboration pursuant to subsection (b)(1) indicates that the requirement also could not apply to the research and royalty activities permitted by subsection (b)(2). The statutory text does not indicate any relevant difference between the two parts of section 273(b). Requiring a Bell company to isolate its network experts from research and royalty arrangements, moreover, would undermine legislators' intent to bring network expertise to bear in manufacturing, in the same way discussed above.

B. The Legislative History of Section 273 Shows That the Separate Affiliate Requirement Applies Only to Manufacturing Pursuant to Subsection (a)

The drafting history of section 273 confirms this structure. The manufacturing provision in the House bill (section 271 of H.R. 1555) — which closely resembles section 273 — contained an explicit separate subsidiary requirement that applied only to general manufacturing activities, not to collaboration, research, and royalty agreements. Subsection (a)(1) of section 271 provided the basic manufacturing rule, and subsection (a)(2) stated that such manufacturing

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[22] This quotation, which refers to the provision of S. 173 that became subsection (b)(1), also illustrates Congress's intent to permit collaboration between any combination of Bell companies, Bell-company affiliated manufacturers, and non-Bell-company affiliated manufacturers. Consequently, the FCC was incorrect in its tentative conclusion that the joint manufacturing prohibition of section 273(a) bars collaboration between a Bell company and the manufacturing affiliate of an unaffiliated Bell company or between the manufacturing affiliates of two unaffiliated Bell companies. NPRM ¶ 11. Indeed, the Commission's tentative conclusion contravenes the statute's plain language ("a Bell company . . . [may] engag[e] in close collaboration with any manufacturer") and improperly applies the joint manufacturing prohibition of section 273(a) to the activities of 273(b), notwithstanding the clause that expressly exempts subsection (b) from the requirements of subsection (a) ("[s]ubsection (a) shall not prohibit . . . .").